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January 15, 1986

LETTER 930

Jan. 3 DJIA 1549.20; PTI 2058; A-D Ratio -10.67
Jan. 10 DJIA 1513.53; PTI 2049; A-D Ratio -11.20

1929? Quite a market we're seeing! On January 7, the Dow and most of the other major averages (with the exception of the non-confirming Transports) hit all-time highs. The next day, January 8, witnessed what many newspapers headlined as "the biggest stock market drop in history!" The 39.10 lost Dow points, of course, represented a loss of 2.5% vs the 12.8% one-day drop of late-1929.

I thought the myriad 1929 comparisons were significant. Those comparisons scared the public. My guess is that when the real top on this bull market finally arrives, 1929 will be forgotten. Nevertheless, we have witnessed an uncorrected rise of over 300 Dow points from the September lows. As I've been saying in recent Letters, sooner or later EVERY movement (primary, secondary or minor) is subject to normal one-third to two-thirds correction. The rise from September will be no exception.

The January 8 spill was undoubtedly set off by the swoon in the bond market (which is also badly in need of a correction). When the bond market sagged, the stock market options swooned and "players" bought the options while selling the stocks ("programmed selling"). Meanwhile, an avalanche of bond options inundated the market, and it was "collapse city" for a while.

What's it all about? Aside from the needed corrections, my own guess is that the Justice Department's coming test of the constitutionality of the Gramm-Rudman bill has upset the bond market. The fact is that Congress has done NOTHING to reduce the (still over \$200 billion) federal deficit, and without Gramm-Rudman they will have done nothing and wasted our time to boot! But Congress's cowardice is not fooling the bond market. I stated before that in 1985 and beyond, the markets will be running this nation. If Congress doesn't move its fanny, if Gramm-Rudman is jettisoned, the bond markets (and rising interest rates) will raise hell in America!

1986: What's going to happen in 1986? That's the big question on everyone's minds and on everyone's lips. The "experts" are lined up to provide (guess at) the answers. From Barron's to Money magazine, from the New York Times to Financial News Network, soothsayers are offering their fearless predictions along with the usual "ifs, and, buts and either ors".

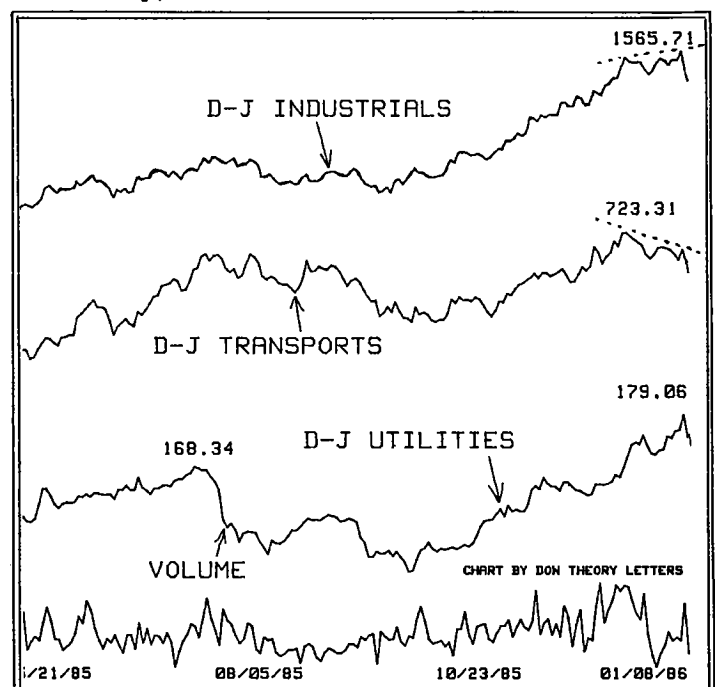
The poor investor, given a thousand opinions and a thousand reasons, is left as confused as ever. Who can you believe? The choices are a dime a dozen -- from collapse to boom to no change. Is there any sanity in the crystal ball business? Is there any answer worth pondering?

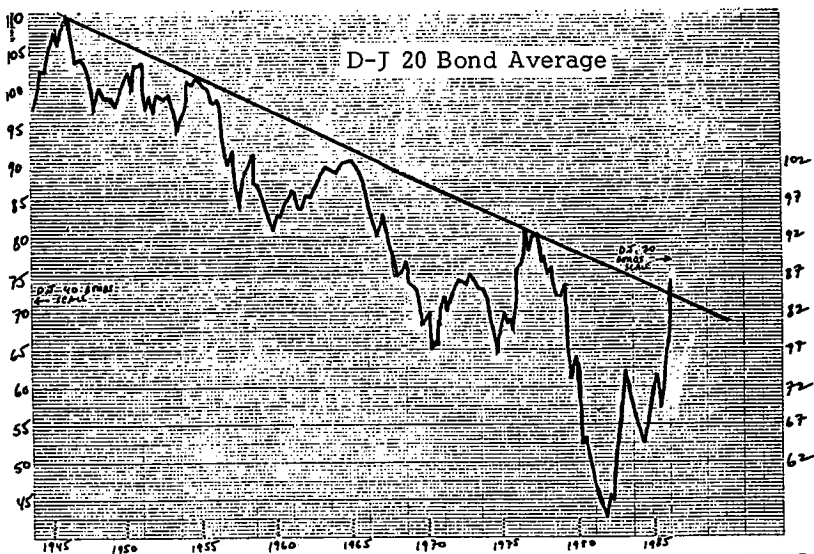
With all the "coming year" nonsense, many investors forget that the best and most accurate predictions are usually made by the markets themselves. And from a market standpoint, the safest way to read the future is to operate on the time-honored concept which states (and this may sound naive) that "THE TREND WILL CONTINUE UNTIL PROVED OTHERWISE."

Of course, this thesis applies most importantly to the primary or main trend of the market. It applies less importantly to the secondary trend of the market. And it's probably dangerous to apply this thesis too precisely to the minor trend (which can change in a day or a few days).

But in the view of the "continuing trend thesis," what can we say about today's markets? Let's take them one at a time. (1) For the stock market the trend is bullish. True, 1985 saw a fat 25.9% increase in the Dow and a 26.3% rise in the S&P 500, but until we get a bear signal we must go on the premise that the primary trend continues bullish. Now remember, I am talking about the primary trend of the market -- not the secondary trend, which would "seem" overdue to turn down one of these days. (For more on the primary trend of the stock market, see the later section on my Primary Trend Index.)

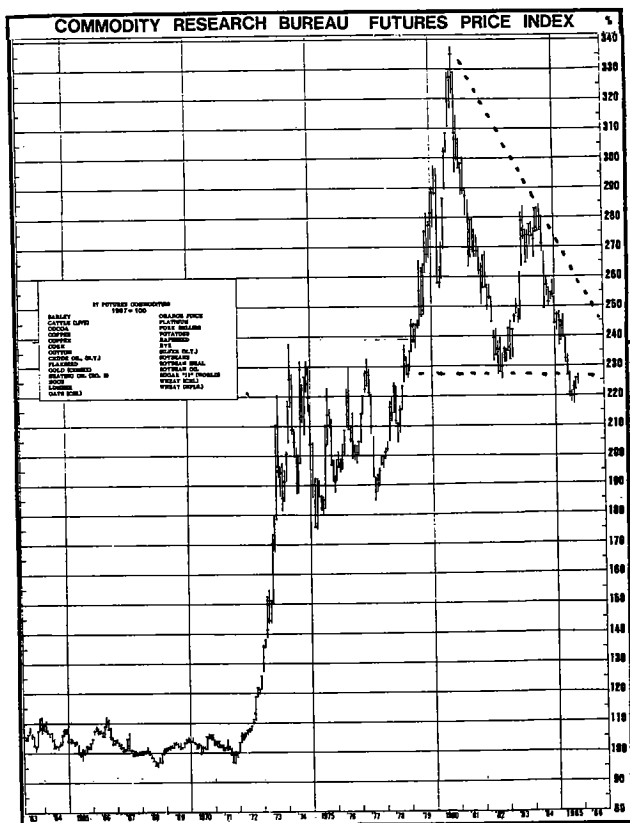
(2) The bonds are also taken to be bullish. This chart of the D-J 20 Bond Average (by my good friend, Jon Strebler of San Diego) shows the dramatic 1985 upside breakout from a 40-year downtrend! Technically, the LONGER a trend is in force, the





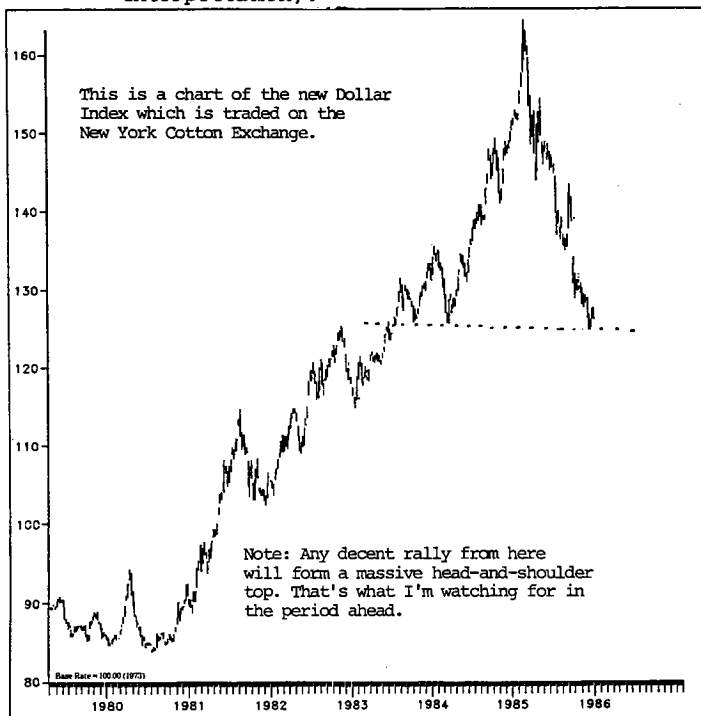
more significance we must give to a breaking of that trend. The downtrend in the bond market was probably THE longest trend existent in any of the tradable markets. Therefore, the recent breaking (to the upside) of the long bearish bond trend must go down as an event of possibly historic importance. We might remember, however, that after the enormous bond rise of 1985, the bonds could be ready to correct. But the major trend of the bonds is up -- that's the important fact in today's money market!

(3) You don't have to be a chart-reading genius to see what's been happening to commodities. This monthly chart of the CRB Index (27 commodities not including gold) shows that the index hit a high of 338 in 1980, broke down to 226 in 1982, rallied above 280 and then in 1985 slid below the 1982 low. In other words, until proved otherwise, the trend of commodities is down (which, of course, is deflationary).



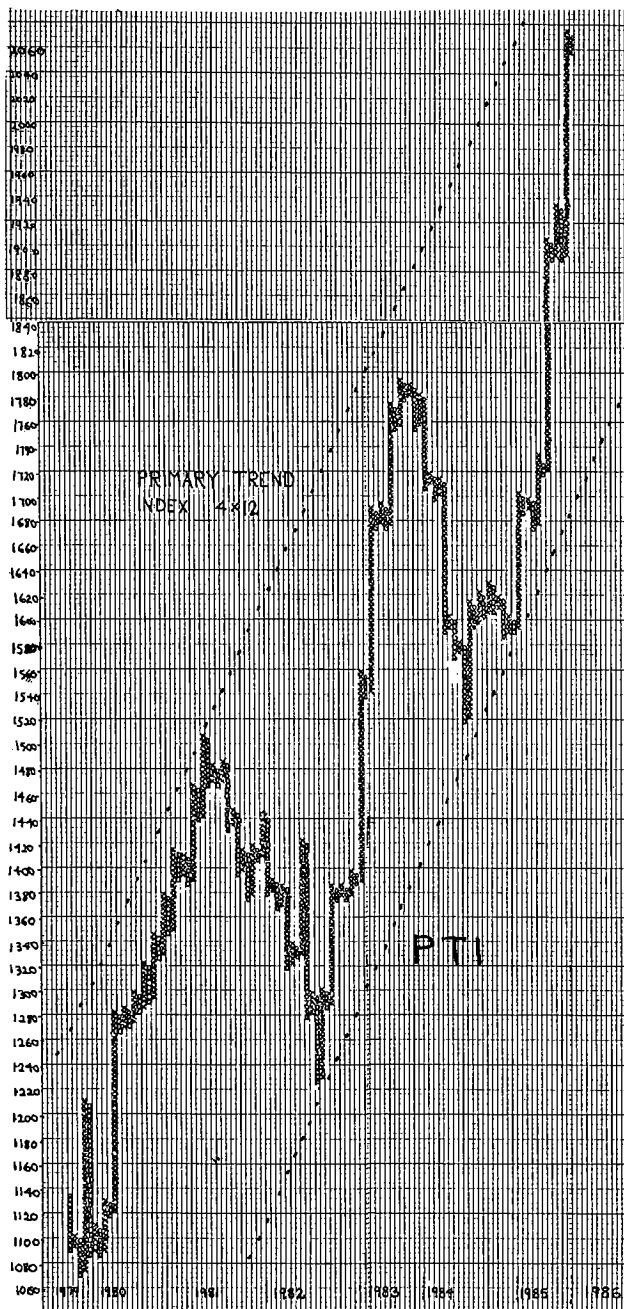
(4) This next chart shows the violent break in the dollar, and because of the extent and duration of the dollar decline I conclude that the primary trend of the dollar is now bearish. This index is based on 10 currencies, but the greatest weight is given to the German mark and the Japanese yen.

PRIMARY TREND INDEX: I guess by now all my subscribers are used to hearing about the PTI and the bull in the box. But I thought that this was a good time to present a perspective on the PTI. For the benefit of newer subscribers, the PTI is my own proprietary invention, a vehicle that I use for tracking the major trend of the market. I have never made its exact composition or construction known, but suffice it to say that the PTI is an amalgam of eight averages and indices -- all based on market ACTION (which means that none of these components is subjective; none is open to opinion or interpretation).



I've been publishing the daily chart on my PTI ever since 1971. And over the years, as veteran subscribers know, the PTI has stood us in good stead. More than that, the PTI has kept me personally from making any number of stupid and even disastrous pronouncements. Because of this, I have adhered to the rule, "Stay with the trend of the PTI. When the PTI is in a bull trend it will (ultimately) take almost all stocks up with it. When the PTI is in a bear trend (in due time) it will take almost all stocks down with it." Then as a corollary I added this (for times when I may feel stubborn), "Ignore the PTI as you wish, but never go against it."

Sounds simple doesn't it? Sounds basic, right? And it is. Furthermore, when you look at this long-term chart (page 3) and when you note the fantastically powerful rise in the PTI it is interesting also to note that there is now a record short position of over 300 million shares on the NYSE. That's right, 300 million shares positioned against the PTI and against the prevailing primary trend (and yes, I know that a lot

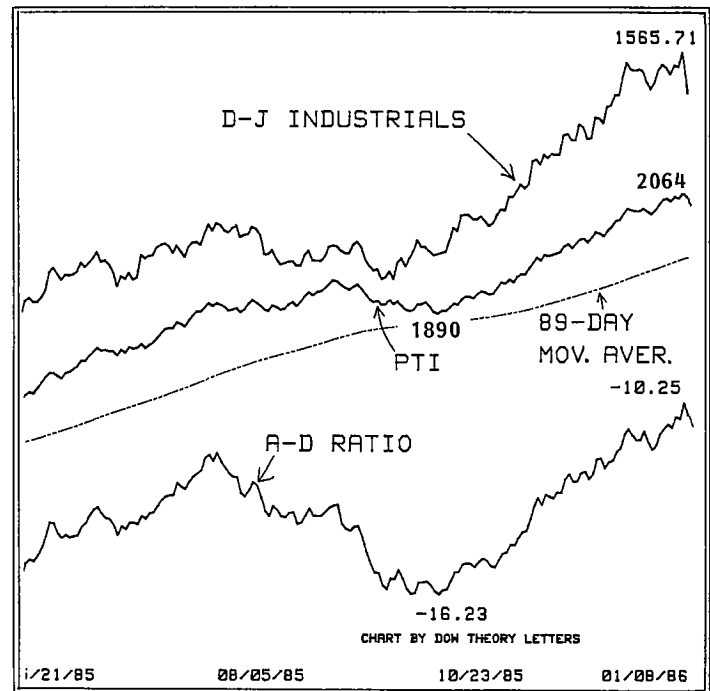


of these shorts represent arbitrage positions; a lot, but hardly all of them!).

I have shown the PTI as climbing a broad bull channel. Major corrections took place during 1981-82 and again during 1983-84. The rise from the 1984 lows has now advanced the PTI an astounding 438 points.

In comparison, the 1979-81 rise took the PTI up 436 points, while the 1982-84 rise advanced the PTI an unbelievable 572 points. I find myself wondering whether in our lifetimes we'll ever again see anything like the rise from the 1979 low in the PTI. Any way you look at it, the action of the last six years has been extraordinary, amazing, historic.

One thing I have learned to do is to refrain from predicting what the PTI will do next. How, for instance, could anyone in his right mind have predicted what would happen to the market in the last half-dozen years? How could anyone have



predicted three massive moves on the upside such as the ones pictured on this chart? So by the same token, I suggest that none of us can know which way the PTI (and the market) is going from here.

So what do we do? We FOLLOW the PTI rather than trying to predict its next direction. We attempt to IDENTIFY the turns rather than playing the genius and forecasting turns. Right now the direction is still up. When that changes, my subscribers will know, and we will act accordingly.

INVESTMENT POSITION: As I stated in the last two reports, it's late to take positions in either stocks or bonds. This market is now testing the nerves of the real investor. But you can imagine what it's doing to the option gamblers. For instance, picture yourself last week with say 10 S&P futures contracts and five T-bond futures. Yeah, you'd be dumping your wares with one hand and wiping your brow with the other. And that's the way it's been going in today's great Wall Street Casino.



And no amount of manipulation, gambling, in-and-out trading or arbitrage is going to change the direction of the great primary trend of the market. All we're getting now is super-volatility, frenzied gambling, and a market that climbs like a rocket, then corrects like a bag of lead sinkers.

The bull is still in the box. The PTI is correcting but is still well above its 89-day moving average. No Dow Theory bear signal has been registered. But the market drop is serving to let the steam out of the market boiler, a phenomenon which has occurred after every big, speculative rise in stock market history. It's just that this drop has the added help of an army of "players". Some of the big players will make their 5 to 7% on the option-stock spreads. And some of the players will have their heads handed to them. As I've said so often, bull markets just don't like too many people aboard.

BONDS, RATES: Here's a daily chart of the March Treasury bond contract (chart courtesy of Dunn & Hargitt). In my opinion, this chart is saying that we've seen the best (the lows) for long-term interest rates for quite a while. The bond market has gone into shock and technically, drops such as the one you see on this chart take time to repair (the same thing, by the way can be said of the stock market).

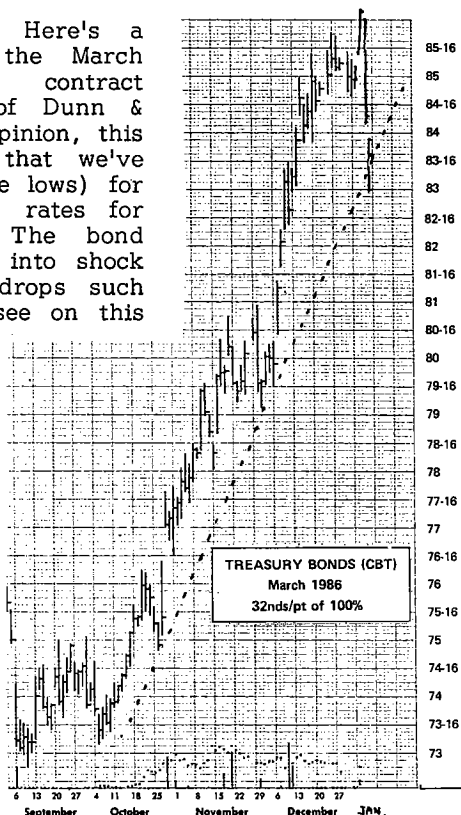
What we see here is a fabulous three-month rising spike in the bonds, and now the possibility of a full one-third to two-thirds correction cannot be written off. If

the bonds continue down, it would not surprise me to see the Fed lean against the wind -- and by this I mean they could cut the discount rate (the bright boys have been promising a cut every day for the last three months, but in my opinion a further drop in the bonds actually will bring on the cut). The last thing the Fed wants to see here is a tumble by the economy into a tight-money recession.

DOLLAR AVERAGING: The concept of buying an equal amount of a stock say every month or so is an old one, and it goes by the name of dollar averaging. The theory is that no one really knows which way the market is going, so the best way to accumulate any stock is to buy on a regular basis, regardless of whether the given stock goes up or down.

Question: What's wrong with this non-timing system? Answer: Suppose you went on a dollar-averaging program beginning in 1926 and you picked RCA for your stock. By 1932 (at the depths of the Depression) you would have lost about 95% of your money and in all probability you would never want to hear about dollar averaging again. Also, you would probably have dumped RCA at the bottom (at around 3½) because you would have been convinced that RCA was going to go belly up along with thousands of other companies.

So what does that tell us? It tells us that (1) you must pick a stock that will survive any bear market, no matter how horrendous that bear market is, (2) you must be prepared to buy in both bull and bear markets. You do that on the premise that (a) your stock will climb during a bull market, and (b) you are buying your stock at greater and greater bargain prices during a bear market. (3) There is a third must, and that is that you must have the cash (reserves) to continue buying in either major bull or major bear markets.



In my judgment, there is only one kind of security that fits the dollar-averaging specifications. That security is the diversified, high-grade fund, whether it be a no-load fund or a closed-end fund.

Here's an example. Tri-Continental (the largest of the NYSE closed-end funds) now has assets of over \$1.3 billion. I have often recommended this stock. TY is a fund which has weathered the Great Depression of the 1930s; TY is here to stay. When you buy TY you are buying a cross section of high-grade equities in a fund that is managed well. It is a fund with a long history. This fund may triple over the next 10 years, it may lose 80% of its value over the next 10 years -- but it is not going belly up. And that concept is crucial.

Why is this "not going broke" concept crucial? All right, it is 1993. The US is in the throes of a horrendous bear market. TY, which you have been buying right along, is down from 1986's 29 to an unbelievable 7. You sweat as you ponder taking your hard-earned savings out of a T-bill and buying your monthly dollar portion of TY. But you say to yourself, "If the US economy is ever coming back, then TY is a bargain. On the other hand, if this is the bitter end, then everything is gone, and it won't make any difference whether I buy more TY or not." So you put another \$1,000 into TY. Two years later, TY is 25, and the market is roaring up. You congratulate yourself on being a steely-nerved genius.

There is one item I should add about the closed-end funds. Unlike the no-load funds which sell at net assets, the closed-end funds (such as Tri-Continental, Lehman, Adams Express, General American Investors, Source Capital) tend to sell at discounts during a bear market, often discounts as much as 30 to 40%. During bull markets these discounts tend to disappear. Thus, the closed-end funds tend to be increasing bargains during a bear market. And for dollar-averaging, I prefer the closed-end funds to the no-load funds.

NOTES & QUOTES: Cars, Planes: Which one is safer? Why guess, I've got the statistics here. Your chance of getting hurt in a car is 1 in 140 trips. Your chance of dying in a car crash is 1 in 5,165. Your chances of dying in a plane crash are 1 in 451,953. Want to be really safe? Your chances of dying in a train crash are 1 in 19,885,920.

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Weird: For years publishers of advisory letters have been whining and crying about SEC registration.

SECURITIES PUZZLE: When the Supreme Court ruled that investment newsletters didn't have to register with the SEC, the agency figured its regulatory load would lighten. But only 25 of 600 newsletters have de-registered. Puzzled officials speculate that many publishers use SEC registration as "Uncle Sam's Seal of Approval."

It's work to register, it's uncomfortable having a federal agency looking over your shoulder. And more importantly, advisory letters don't handle accounts, they just publish their opinion. So why do we have to register?

After all the debate, the Supreme Court finally ruled that we did not have to register. Great, what a boon. So what happened? This WSJ squib tells it all. I can't figure it out, except to say that the average advisor doesn't have the brains to write the SEC for the de-registration forms and then fill out the forms. Yes, I am one of the 25 who de-registered.

Catch-up? Everyone's been amazed by the stock market's performance in 1985, but I wonder if we have not simply been seeing Wall Street catch up with the rest of the world? Of 20 world stock indices, the US during 1985 trailed behind 14 of them (the US market was also below Capital Int. Perspective's World Index Average). Only Singapore, S. Africa, Mexico, Canada and Australia trailed the US in '85. The US index was up 27%. In contrast, Austria was up 170%, W.Germany was up 131%, Italy was up 125%, Switzerland was up 103%, France was up 80%, Belgium was up 65%, Norway was up 61% and on and on. Thus, the US market could just be catching up with most of the world's markets (particularly European markets).

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In a distressingly true article (Newsweek, Dec. 30) Hal Willard tells how he went "broke with a million". The following is from that piece.

Liquid assets: When cash flow became a trickle, but our obligations continued at the freshet stage, we poured in liquid assets: stocks, bonds, Treasury notes. Then real estate. We were determined to pay creditors and we were optimistic that all would be well when the recovery came. But we also encountered problems the American economic system creates for people who suddenly are without an expected amount of money.

Government, at all levels, is relentless. There is a long list of taxes, charges and fees that must be paid by businesses—and penalties when you're late. If you go broke, tough. Besides income taxes and sales taxes, there is unemployment insurance, workers' compensation, traders' licenses, property taxes, personal property taxes and more. When we closed two shops in 1982, and the employees we laid off filed for unemployment compensation, our unemployment-insurance rate went up from .01 percent of the payroll to 4.7 percent; from less than \$25 to several hundred dollars. We protested we were being penalized for losing money, but it was state law.

Banks are just as unyielding. They are masters of the art of piling on fees, charges, penalties and "points"; their lobbyists are expert at manipulating legislators into passing laws that allow it.

* *

1986 Bonus: A lot of newer subscribers must wonder what this character, Russell, looks like. All right, here I am. This pic was taken last November in New Orleans at the kitchen of the famous K-Paul's restaurant. That's me on the left, kidding around with Chef Paul Prudhomme, the man who almost single-handedly popularized Cajun food. Big Paulie weighs in at roughly 400 pounds. And as you can see by my tummy, I had one huge Cajun meal that night (one of the best dinners I've ever had!).



PERFECT ELEVEN: The new year has started, and I'm going to repeat one of the most popular pieces I have written in 28 years of writing these reports. It is my piece on the "ideal business". I have received numerous requests for this piece from individuals and institutions over the years, and I reckon it's a good time to repeat it.

So here goes:

IDEAL: There's no such thing as a "perfect Democracy", and there probably never will be. But political experts can describe what the perfect Democracy would be like. Therefore, you can rate any supposed Democracy on how close it comes to the ideal.

By the same token, there never was a perfect business, and there never will be. But let us assume that any business exists to produce profits (of course, a business can do a thousand other things, but if it is to exist, it must produce profits). I have long pondered on the various factors which might combine to produce the perfect business. I have been in a number of businesses myself (everything from textile designing to book publishing to owning a nightclub on the side), and I have talked to hundreds of successful businessmen (and some less than successful). During all those years, I have always wanted to get a list of "ideal factors" together.

The following is my list (at least, up to this point). You might gauge your own business or profession on the basis of this list, or you may want to use this list as a reference for measuring the potential for a new enterprise.

(1) The ideal business sells the world, rather than a single neighborhood or a single city or locality (in other words, it has a huge market).

(2) The ideal business has a product with "inelastic demand". This means that people need it, almost regardless of price.

(3) The ideal business has low labor requirements; the fewer people needed, the better.

(4) The ideal business sells a product which fits a continuing human (or animal) need. It's not a fad product, it's not a product which people can easily substitute or even do without.

(5) The ideal business has low overhead; it does not need an expensive location, it does not need large amounts of electricity, advertising, legal advice, etc.

(6) The ideal business produces a product which is difficult (or almost impossible) for a competitor to copy or reproduce. This means the product is an original (such as a publication) or it requires very special knowhow, or it produces a product which is protected by a copyright or patent.

(7) The ideal business doesn't require huge cash expenditures or large investments in equipment. In other words, it does not tie up your money.

(8) The ideal business is a business that has cash billings; it does not tie up your money in extended credit arrangements.

(9) The ideal business is relatively free from all kinds of government and industry regulations.

(10) The ideal business is portable. You can put it anywhere you want, in Florida, California, the Canary Islands.

(11) Here's a crucial but overlooked one: the ideal business is one that holds your full intellectual (and often your emotional) energies.

There you are. If you use this list, it might help you cut through a lot of nonsense and hypocrisy about what you are doing and what you are looking for.

GOLD: I stated in Letter 928 (Dec. 18) that gold tends to make a low in the fourth quarter of each year and then rally into the first quarter. On that basis, I then pointed to the 315.50 low of Dec. 11, and opined that there was a good chance that the December 315.50 low was important. Events since then have strengthened that view.

Another of my theses is that the background for gold is bullish ONLY when the gold-common stock ratio is climbing in favor of gold. On Dec. 16, the gold-divided-by-the-Dow ratio struck a five-year low of 261. Since then the ratio has been climbing in favor of gold with a reading of 281 on Jan. 9 (highest level since late-November).

As you can see on my computer-drawn chart, gold is now pushing up and away from its 144-day moving average, obviously a positive sign. As for momentum, last week momentum again rose bullishly above the critical 1.0 line -- so this chart is on "go" for gold.

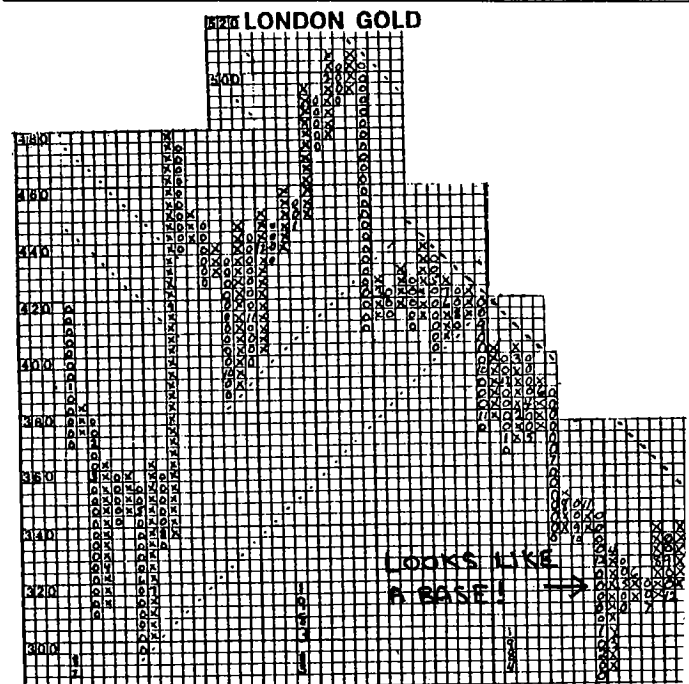
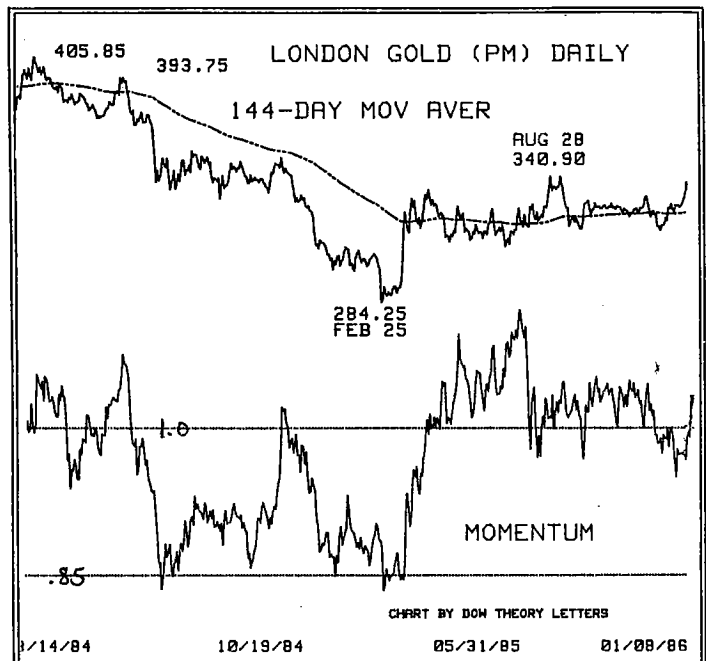
The first gold target (and I've been talking about this point for over six months) is last February's London fix of 340.90 (see chart). The second target is the point & figure breakout level of 344. So gold is now looking increasingly bullish, despite anything you may hear to the contrary.

By the way, from what I gather all sales in any gold coins which are legal for settling futures contracts must be reported by dealers to the IRS. The two coins I am referring to are the Maple Leaf and the Krugerrand. This leaves the Pandas, the Mexican peso and the Kronas as non-reportable. I leave it to you to decide which gold coins are preferable at this point. Premiums above gold content on the Kronas and the pesos are small. The Chinese Panda demands a rather fat premium, but this is a pure 1-ounce gold coin and does have some collector value (at least the 1982 through 1984 Pandas do). Happy coin collecting, especially if gold can get above 344 on a London fix.

Speculations: People drop their life savings at Vegas every day of the week. The California Lottery in the first nine months of operation took in an unbelievable \$800 million. So people love to gamble. But there is a more intelligent way to flip your coins, if you can't kill that gambling bug. What is the way? Buy speculative stocks in industries that make sense.

With the turmoil in S. Africa, many goldphiles are now turning to North America for gold shares. It's been a long time since there has been any real fire in the gold share market, but three low-priced gold speculations worth looking at are (1) Grandview Resources, Vancouver-GND, a mine located east of San Francisco (and a pick by my good friend, Doug Casey). Two more gold stocks on the Vancouver Exchange are Skylark Resources (SRR) and Viscount

Resources (VIS). A package of all three in equal dollar amounts might be an interesting speculation -- if you have the patience to wait for the next major gold rise.



FINAL NOTES: When I said in the last Letter that 1986 "would not be as much fun as 1985," I was referring to the fact that the S&P 500 has never been up five years in a row. Last year (1985) was the 4th year up. On the last rally, the Transports (see chart 1) did not confirm the new Dow high, and the stock market was wounded by the smash of Jan. 8 and 9. I think it will go lower. A simple 1/3 correction of the Sept. to Jan. rise would take the Dow to the 1460 area. We got the first bullish upside breakout in gold on Jan. 10 when gold closed at a spot price of 341.75 (N.Y.). Accordingly, I made my first fairly large purchase of gold coins (up to this point, I've just been nibbling).

NEXT MAILING: Jan. 29